

## Resource sharing arrangements

- 4.1 The fundamental function of the Treaty is to provide a framework in which levels of fiscal and legal security are adequate to allow the development of the resources of an area of the Timor Sea seabed that is currently subject to overlapping claims by Australia and East Timor.
- 4.2 The resource sharing arrangements set out in Article 4 of the Treaty provide for East Timor having title to 90 percent of the resources of the JPDA and Australia having title to 10 percent. Annex E of the Treaty provides for the unitisation of the Greater Sunrise oil and gas fields on the basis that 20.1 percent lies within the JPDA and 79.9 percent lies within Australian jurisdiction.

### The Bayu-Undan Field

- 4.3 The participants in petroleum activities in the Bayu-Undan oil and gas field include Phillips Petroleum, Inpex Sahul, Santos and Petroz.
- 4.4 Phillips has estimated that the Bayu-Undan field contains 400 million barrels of condensate and liquified petroleum gas (LPG) and 3.4 trillion cubic feet of natural gas.<sup>1</sup>
- 4.5 The Bayu-Undan participants intend to develop the resources in two phases. The first phase involves stripping the extracted gas of its liquids, reinjecting the gas into the ground and selling the liquids. They expect production from this phase of the project to commence in early 2004 with

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<sup>1</sup> Phillips Petroleum, *Submission No. 36*, p. 3.

production peaking at around 110,000 barrels per day of condensate and LPG.<sup>2</sup>

- 4.6 The second phase of the development involves piping gas to Darwin for export to Japan. The Bayu-Undan participants have contracted to supply 3 million tonnes of LNG a year to Tokyo Electric Power Company and Tokyo Gas for a period of 17 years commencing in January 2006.<sup>3</sup>

## Benefits to East Timor and Australia

### East Timor

- 4.7 The royalties and taxation revenue flowing to East Timor should amount to between \$US2.5 – \$US3 billion.<sup>4</sup> East Timor expects to receive \$US70 million (\$A127 million) in 2004. Revenue is expected to peak at \$US300 million in 2013.<sup>5</sup>
- 4.8 In addition to this direct revenue flow, the participants have pledged \$US13 million of direct investment for associated project training and community infrastructure, such as port, airport and health facilities, in East Timor. They will also spend \$US44 million in on-going costs in East Timor over the 20 year life of the project.<sup>6</sup>
- 4.9 In terms of the employment and training of nationals and permanent residents of East Timor:

As part of the installation phase of the gas recycling project, a total of 61 East Timorese are working offshore and onshore. This number includes four East Timorese who, after attending the Madang Maritime college in PNG ... are now serving the required sea time to obtain the Seaman Grade 2 qualification ...

Phillips has committed \$US2 million to be invested from now until March 2004 in training ... A further \$US5 million over the next 10 years has been committed to provide additional on-the-job training, subject only to the LNG project going ahead [that is phase two of the project].<sup>7</sup>

2 Phillips Petroleum, *Submission No. 36*, p. 3.

3 Phillips Petroleum, *Submission No. 36*, p. 3.

4 Phillips Petroleum, *Submission No. 36*, p. 4.

5 Mari Alkatiri, 'Timor Sea Oil is Passport from Poverty', *Australian Financial Review*, 2 September 2002.

6 Phillips Petroleum, *Submission No. 36*, p. 4.

7 Mike Nazroo, *Transcript of Evidence*, 2 October 2002, p. 50. (The \$US2 million and \$US5 million are in addition to the \$US13 million dedicated to training and infrastructure. Mike Nazroo, *Transcript of Evidence*, 2 October 2002, p. 56.)

- 4.10 A further benefit to East Timor will be the supply of LPG from the second phase of the project at a concessional rate which Phillips estimates to be worth 'some \$A20 million over the next 20 years.'<sup>8</sup> The supply of cheap LPG will enable East Timor to replace imported diesel fuel for power generators.

## Australia

- 4.11 Australia stands to gain an estimated \$A2 billion in direct revenue from the exploitation of the resources of the Bayu-Undan over the life of the project.<sup>9</sup>
- 4.12 At the time of writing, 20 new jobs have been created in Darwin and 54 jobs Australia-wide.<sup>10</sup> The construction of the LNG plant in Darwin will create an estimated 1,200 jobs.<sup>11</sup> During the operation phase the LNG plant will create 100 direct jobs and between 300 and 500 indirect jobs for 20 years. The construction of the pipeline from the Bayu-Undan to Darwin together with investments in Darwin are estimated at approximately \$US1.5 billion.<sup>12</sup>
- 4.13 Bayu-Undan gas will not supply an Australian LNG market. The complete resources of the Bayu-Undan have been committed to overseas customers.<sup>13</sup>

## The Greater Sunrise Field

- 4.14 The participants in the development of the Greater Sunrise oil and gas fields include Woodside Energy, Phillips Petroleum and Shell Development.
- 4.15 At the time of writing Woodside estimated the Greater Sunrise fields to contain about 8 trillion cubic feet of gas.<sup>14</sup> The Government of the Northern Territory estimates that the fields contain approximately 300 million barrels of condensate.<sup>15</sup>
- 4.16 Woodside stated that work on the Greater Sunrise venture has been:

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8 Mike Nazroo, *Transcript of Evidence*, 2 October 2002, p. 51.

9 Phillips Petroleum, *Submission No. 36*, p. 4.

10 Mike Nazroo, *Transcript of Evidence*, 2 October 2002, p. 50.

11 Phillips Petroleum, *Submission No. 36*, p. 5.

12 Mike Nazroo, *Transcript of Evidence*, 2 October 2002, p. 54.

13 Mike Nazroo, *Transcript of Evidence*, 2 October 2002, p. 60.

14 David Maxwell, *Transcript of Evidence*, 14 October 2002, p. 265.

15 Andrew Andrejewskis, *Transcript of Evidence*, 3 October 2002, p. 71.

what we would consider assessment work, scoping work, concept work and screening work to try to understand what is the best way to go forward and develop this field.<sup>16</sup>

- 4.17 Woodside informed the Committee that to progress to the next stage, 'what we refer to as the basis of the design phase ...', would involve a potential commitment of \$A200 million.<sup>17</sup> The overall investment in the project is an estimated at \$A6 billion.<sup>18</sup>
- 4.18 The timetable for committing to the design phase is currently scheduled for the first quarter of 2003.<sup>19</sup> Woodside has a target date of October 2008 for the first sales of gas.<sup>20</sup>

## Benefits to Australia and East Timor

- 4.19 At the time of writing this report the IUA is still the subject of negotiations between Australia and East Timor. The amounts of direct fiscal benefits given in the following section are subject to the Sunrise IUA confirming that Australia and East Timor will have title to 79.9 percent and 20.1 percent respectively of the resources of the Greater Sunrise as provided for in Annex E of the Treaty.
- 4.20 Because of the relatively early stages of development of the Greater Sunrise resources the Committee was not provided with the complete detail of the fiscal and development benefits to Australia and East Timor.
- 4.21 Over the length of the project, with Sunrise gas being processed using a floating liquefied natural gas (FLNG) facility (the stated preferred option of the participants), Australia and East Timor could expect over \$A30 billion in export revenues and approximately \$A8 billion in taxes.<sup>21</sup>
- 4.22 Shell and Woodside are investing \$A11 million in FLNG technology.<sup>22</sup>

## Australia

- 4.23 The Committee heard that, under current expectations of the tax structures, the resources of the Greater Sunrise would be worth an estimated \$A400 million a year to Australia.<sup>23</sup>

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16 David Maxwell, *Transcript of Evidence*, 14 October 2002, p. 262.

17 David Maxwell, *Transcript of Evidence*, 14 October 2002, p. 260.

18 David Maxwell, *Transcript of Evidence*, 14 October 2002, p. 260.

19 David Maxwell, *Transcript of Evidence*, 14 October 2002, p. 263.

20 David Maxwell, *Transcript of Evidence*, 14 October 2002, p. 266.

21 Shell Development, *Submission No. 51*, p. 2.

22 Shell Development, *Submission No. 51*, p. 2.

23 David Maxwell, *Transcript of Evidence*, 14 October 2002, p. 265.

- 4.24 Apart from the direct revenue, the Committee explored the benefits that would flow to Australia if the Sunrise venture partners opt to bring the resource onshore rather than processing offshore on a FLNG facility, as well as the possibility of the gas being used to supply the domestic market.
- 4.25 In the event that Sunrise participants brought gas onshore Peter Brain of the National Institute of Economic and Industry Research, who was engaged by the Northern Territory Chamber of Commerce and Industry and the Territory Construction Association, estimated the financial benefit to be in the order of \$A22 billion with the employment of a workforce of about 20,000 people.<sup>24</sup> If the Sunrise partners choose the FLNG option, the Committee was advised that the benefits would be in the order of \$A1 million.<sup>25</sup>
- 4.26 The Sunrise development requires the consumption of approximately 900 terajoules extra per day to be economically viable. This figure can be put into perspective in view of the fact that the entire east coast market is 1,400 terajoules a day.
- 4.27 The Northern Territory Government canvassed possible domestic customers for Sunrise gas. These included:
- a number of mineral processing projects, aluminium smelting, alumina refining such as [Alcan] Gove, a zinc refinery at McArthur River and some other mineral processing areas south of Darwin.
  - There are customers in Australia, including the piping of gas to South Australia, New South Wales via Moomba and the potential also to go to the Mount Isa region.<sup>26</sup>
- 4.28 The role of the expansion of current projects and the development of new projects was emphasised as the key to increasing domestic consumption to the required amount to make onshore processing and supply of Sunrise gas viable:
- If we look at an aluminium smelter plus the new zinc smelter plus expansion on Gove plus power just in the Northern Territory alone, that would take care of something of the order of half of that particular 980 [terajoules] or close to it.<sup>27</sup>
- 4.29 It was pointed out that the relation between consumption and supply is not all one way. The supply of gas is likely to increase consumption:

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24 Bruce Fadelli, *Transcript of Evidence*, 3 October 2002, p. 65.

25 Bruce Fadelli, *Transcript of Evidence*, 3 October 2002, p. 66.

26 Andrew Andrejewskis, *Transcript of Evidence*, 3 October 2002, p. 72.

27 Andrew Andrejewskis, *Transcript of Evidence*, 3 October 2002, p. 74.

Sunrise is critical to the establishment of some of the customers I mentioned ... Without the large volume of gas that Sunrise could supply, these projects could not proceed.<sup>28</sup>

Further:

Natural gas is not available in sufficient quantities in the Central Australian region to underpin development ... of energy-hungry projects [such as large scale hard rock mining].<sup>29</sup>

- 4.30 The Northern Territory Government and the Northern Territory Minerals Council also referred to increased competition in the domestic market as a result of bringing gas onshore which, the Committee was advised, could actually reduce the price of gas in various states in real terms by 10 cents or 20 cents per gigajoule.<sup>30</sup>

### East Timor

- 4.31 East Timor could expect to receive approximately \$A100 million a year from the development of Sunrise resources under the terms stated in Annex E of the proposed Treaty.
- 4.32 In terms of indirect benefits flowing to East Timor from the development of Sunrise resources, Woodside acknowledged that the Treaty provides for the training and education of East Timorese. David Maxwell stated that:
- based on past experiences in other projects, we would seek to work with both the Australia side and the East Timor side to maximise opportunities for both ... Provided that people have suitable capacity and capabilities ... we would support training and development on both the Australia side and the East Timor side.<sup>31</sup>

### The national interests of Australia and East Timor

- 4.33 The Committee acknowledges that its purpose is to provide for parliamentary and public scrutiny of treaty actions in terms of their promotion or obstruction of Australia's national interest. It is for the Government and Parliament of East Timor to represent the interests entrusted to them. However, the Committee understands that:

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28 Andrew Andrejewskis, *Transcript of Evidence*, 3 October 2002, p. 75.

29 Kezia Purick, *Transcript of Evidence*, 3 October 2002, p. 82.

30 Andrew Andrejewskis, *Transcript of Evidence*, 3 October 2002, p. 79.

31 David Maxwell, *Transcript of Evidence*, 14 October 2002, p. 266.

Australia has an interest in promoting East Timor's future economic viability ... underpinned by Timor Sea revenue.<sup>32</sup>

- 4.34 The inquiry's terms of reference require the consideration of the implications of the proposed ratification of the Timor Sea Treaty in terms of Australia's national interest. Persuasive arguments were made that the national interests of Australia and East Timor are interrelated – the Treaty does not represent a zero sum game in which one party's gain is the other party's loss.
- 4.35 The Australian Council of Trade Unions (ACTU) focused upon the interrelation of the national interests of Australia and its neighbours observing that the rim to the north of Australia was an area of instability.<sup>33</sup>
- 4.36 Alan Matheson, representing the ACTU, illustrated, in more direct terms, how the instability of states within this rim might have an adverse influence on Australia's national interest:

Nauru is now in the top five of money launderers internationally. The last figures I saw were between \$70 million and \$150 million [of] Russian drug money being laundered through the front door in Nauru. While compensation and payments came ... they came too late. But certainly the governance of Nauru would not be what you would be hoping for in terms of the Timorese.<sup>34</sup>

- 4.37 The significance of the income from the Bayu-Undan to East Timor is brought into perspective when it is recognised that the annual budget of East Timor is about \$US77 million, of which \$US30 million is aid from foreign donors.<sup>35</sup>
- 4.38 The Uniting Church informed the Committee that:
- East Timor has only a 40% literacy rate, a GNP per capita of less than \$US340, life expectancy of 48 years and an infant mortality rate of 135 per thousand live births. The maternal mortality rate is reported to be twice that of other countries in South East Asia and the Western Pacific.<sup>36</sup>

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<sup>32</sup> Geoffrey Raby, *Transcript of Evidence*, 12 July 2002, p. 22.

<sup>33</sup> Alan Matheson, *Transcript of Evidence*, 4 October 2002, p. 183.

<sup>34</sup> Alan Matheson, *Transcript of Evidence*, 4 October 2002, p. 185.

<sup>35</sup> Mari Alkatiri, 'Timor Sea Oil is Passport from Poverty', *Australian Financial Review*, 2 September 2002.

<sup>36</sup> Uniting Church in Australia, *Submission No. 34.1*, p. 2.

- 4.39 The Uniting Church also noted that Australia had reduced its overseas development assistance by 12.7 percent in the 2002-03 budget to \$A36 million.<sup>37</sup>
- 4.40 DFAT informed the Committee that the decline in the level of funding is in accordance with a \$A150 million four year funding plan for the reconstruction and development of East Timor, announced by the Australian Government in May 2000. \$A40 million per annum was allocated for 2000-01 and 2001-02 and \$A35 million per annum allocated for 2002-03 and 2003-04. This aid package follows Australian assistance of \$A81 million in 1999-2000.<sup>38</sup>
- 4.41 Oxfam/Community Aid Abroad referred to the decline in Australian funding as reflecting a more general trend among international donors to East Timor:
- International donors... may well carry [East Timor] through to 2004-05, but beyond that it is very unlikely they will get [current levels] of budgetary support. Donors are expecting that an agreement will be reached and their exit strategy, if you like, is the revenue stream that will come from the Timor Gap.<sup>39</sup>
- 4.42 If the Bayu-Undan development were not to proceed because of a delay in the ratification of the Treaty, East Timor would lose the principal foundation of its economic viability:
- the political and social consequences of ... not having a viable source of income would be very serious ...<sup>40</sup>

## Timing of ratification

- 4.43 The necessity of prompt ratification of the Treaty for ensuring certainty to the Bayu-Undan developers has been put forcefully by the Prime Minister of East Timor, Mari Alkatiri:
- In a fickle and oversupplied world gas market ... uncertainty might deter investment for decades to come, perhaps forever.<sup>41</sup>
- 4.44 Phillips informed the Committee that the Bayu-Undan participants were committed to the delivery of liquified natural gas (LNG) to Japanese

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37 Uniting Church in Australia, *Submission No. 34.1*, p. 2.

38 Department of Foreign Affairs, *Exhibit No. 13*, p. 1.

39 Peter Chamberlain, *Transcript of Evidence*, 4 October 2002, p. 176.

40 Peter Chamberlain, *Transcript of Evidence*, 4 October 2002, p. 177.

41 Mari Alkatiri, 'Timor Sea Oil is Passport from Poverty', *Australian Financial Review*, 2 September 2002.

customers by January 2006. In order to meet this obligation they required construction to begin on the LNG processing plant in Darwin by November 2002. They require the certainty provided by the entry into force of the Treaty before commencing construction.<sup>42</sup>

- 4.45 Santos specified the time constraints imposed upon the Bayu-Undan participants to deliver their product within their contractual obligations and thus a satisfactory timetable for ratification of the Treaty could:

move a few weeks but it will not move a few months.<sup>43</sup>

- 4.46 The Bayu-Undan participants require the ratification of the Treaty so that an Understandings Agreement they have with the Government of East Timor will come into effect. The Understandings Agreement covers the new Production Sharing Contracts (PSCs) that will become necessary on the entry into force of the Treaty:

The PSC needs to have the force of law. I think the treaty would be required to give us that comfort.<sup>44</sup>

- 4.47 The Understandings Agreement was made necessary for two reasons. First, because of the changing tax regime that resulted from the alteration of the title to the resources of the JPDA from a 50:50 split under the terms of the Timor Gap Treaty to the 90:10 split under the Timor Sea Treaty.<sup>45</sup>

- 4.48 The applicable tax regime under the former arrangement was that 50 percent of the resource was taxed at the Australian rate of about 30 percent and 50 percent of the resource was taxed at the Indonesian rate of about 45 percent. Under the new regime the applicable tax rate would be 10 percent of the resource being taxed at about 30 percent and 90 percent of the resource being taxed at 45 percent.

- 4.49 The Bayu-Undan participants also require protection from double taxation that is provided in Annex G of the Treaty in order to provide fiscal security for their investment.<sup>46</sup>

- 4.50 The Understandings Agreement is also necessary because the old PSCs do not adequately provide for the production of gas, which is involved in the second phase of the Bayu-Undan development.<sup>47</sup>

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42 Phillips Petroleum, *Submission No. 36*, pp. 2-3.

43 Michael Price, *Transcript of Evidence*, 8 October 2002, p. 222.

44 Michael Lawry, *Transcript of Evidence*, 8 October 2002, p. 219.

45 Mike Nazroo, *Transcript of Evidence*, 2 October 2002, p. 52 and Wesley Glanville, *Transcript of Evidence*, 8 October 2002, p. 215.

46 Mike Nazroo, *Transcript of Evidence*, 2 October 2002, p. 52 and Michael Price, *Transcript of Evidence*, 8 October 2002, p. 220.

47 Wesley Glanville, *Transcript of Evidence*, 8 October 2002, p. 219.

- 4.51 The argument for securing the certain benefits flowing from the Bayu-Undan was put by Wesley Glanville, a representative of Santos, who argued that:

Greater Sunrise still has not resolved what its development process will be. To delay the ratification of the Timor Sea Treaty would prejudice commercially an existing, advanced development in Bayu-Undan.<sup>48</sup>

- 4.52 The Committee accepts that there is a degree of uncertainty that accompanies a major development, like the Greater Sunrise, that is in its early phases. The benefits that will flow to Australia cannot be determined with any certainty because of a number of unknown factors. For instance, not only is the amount of direct revenue to Australia uncertain because of the absence of an IUA, but the indirect benefits, such as employment, are uncertain because the method of processing the resource is not yet decided.

- 4.53 Mr Glanville argued that adequate provision for good faith negotiations over the IUA were already in place:

Delaying the ratification of the Timor Sea Treaty pending the Sunrise International Unitisation Agreement would be against the terms and spirit of the 20 May Exchange of Notes and Memorandum of Understanding.<sup>49</sup>

- 4.54 Woodside expressed concern that ratifying the Treaty separately to the IUA may lead to undesirable outcomes for the Greater Sunrise participants and the Australian national interest:

The East Timor side may see benefit in allowing [IUA negotiations] to drag as it becomes more important to Australia because Australia under the current structure enjoys more of the returns from the Greater Sunrise project. Allowing it to drag may be a negotiating tactic on the part of the East Timorese to extract more value out of the unitisation agreement.<sup>50</sup>

- 4.55 Woodside's point was supported by Geoffrey Raby (DFAT) who suggested that ratification of the Treaty before the IUA:

would probably diminish the incentives on behalf of the negotiators to move quickly through the IUA.<sup>51</sup>

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48 Wesley Glanville, *Transcript of Evidence*, 8 October 2002, p. 219.

49 Wesley Glanville, *Transcript of Evidence*, 8 October 2002, p. 213.

50 David Maxwell, *Transcript of Evidence*, 14 October, p. 264.

51 Geoffrey Raby, *Transcript of Evidence*, 14 October 2002, p. 271.

4.56 Because the Greater Sunrise constitutes a far larger resource in which Australia has a far larger stake Dr Raby concluded:

That the national interests are served most by ensuring that our disproportionately bigger interest in the Greater Sunrise is protected.<sup>52</sup>

4.57 The Committee suggested that a delay in the ratification of the Treaty may jeopardise the \$A2 billion in revenue that will flow to Australia upon the development of the Bayu-Undan. DFAT responded that:

The resource does not disappear simply because a particular arrangement does not proceed in a certain timeframe.<sup>53</sup>

## Conclusions and recommendations

4.58 In the light of the evidence the Committee notes that the ratification of the Treaty is a fundamental condition precedent to the exploitation of the resources that lie beneath the Timor Sea. Significant benefit to the people and economies of the nations of Australia and East Timor will result from the immediate development of the Bayu-Undan and the ultimate development of the Greater Sunrise fields.

4.59 The Committee considers that there is an urgent need to progress negotiations on the IUA to provide the necessary certainty to allow the substantial investment required for the development of the Greater Sunrise fields, the economic and taxation benefits from which will ultimately be of significant benefit to both Australia and the emerging economy of East Timor.

4.60 The Committee notes that the Treaty was concluded on the basis of an MOU signed by Australia and East Timor on 20 May 2002 affirming that an IUA for the Greater Sunrise will be concluded by 31 December 2002.

### Recommendation 1

4.61 **The Committee supports the Timor Sea Treaty and recommends that binding treaty action be taken.**

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52 Geoffrey Raby, *Transcript of Evidence*, 14 October 2002, p. 275.

53 Geoffrey Raby, *Transcript of Evidence*, 14 October 2002, p. 275.

**Recommendation 2**

- 4.62 **The Committee recommends that the Government of Australia use its best endeavours in accordance with the Memorandum of Understanding signed in Dili on 20 May 2002 to conclude the International Unitisation Agreement for the Greater Sunrise fields on or before the date on which the Timor Sea Treaty is ratified and in any event before 31 December 2002 as this would serve the best interests of both nations.**